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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88209; File No. SR-NASDAQ-2020-007]

### **Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Assume Operational Responsibility for Certain Enforcement Functions Currently Performed by FINRA under the Exchanges Authority and Supervision**

February 13, 2020

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 3, 2020, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange proposes to assume operational responsibility for certain enforcement functions currently performed by the Financial Industry Regulatory Authority (“FINRA”) under the Exchange’s authority and supervision. Specifically, the Exchange proposes to assume operational responsibility for litigating contested disciplinary proceedings arising out of Nasdaq Regulation-led investigation and enforcement activities. In carrying out that responsibility, the

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Exchange plans to engage a third party, such as a law firm or another self-regulatory organization. Nasdaq Rule General 1, Section 7<sup>3</sup> requires Commission approval for this proposal.

The text of the proposed rule change is available on the Exchange's Website at <http://nasdaq.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Section 6 of the Act requires that national securities exchanges enforce their members' compliance with federal securities laws and rules as well as the exchanges' own rules.<sup>4</sup> As a self-regulatory organization ("SRO"), Nasdaq must have a comprehensive regulatory program that includes investigation and prosecution of violative activity. Since it became a national securities exchange, Nasdaq has contracted with FINRA through various regulatory services agreements ("RSAs") to perform certain of these regulatory functions on its behalf. However, as the Commission has made clear, "the Nasdaq Exchange bears the responsibility for self-

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<sup>3</sup> Formally Nasdaq Rule 0150.

<sup>4</sup> 15 U.S.C. 78(f).

regulatory conduct and primary liability for self-regulatory failures, not the SRO retained to perform regulatory functions on the Exchange's behalf.”<sup>5</sup>

In April 2019, Nasdaq received Commission approval to reallocate operational responsibility from FINRA to Nasdaq Regulation<sup>6</sup> for certain investigation and enforcement activity<sup>7</sup>, namely:

- investigation and enforcement responsibilities for conduct occurring on The Nasdaq Options Market,<sup>8</sup> and
- investigation and enforcement responsibilities for conduct occurring on Nasdaq's equity market only, i.e., not also on non-Nasdaq-affiliated equities markets.<sup>9</sup>

Notwithstanding that approval, FINRA continues to perform certain functions pursuant to a RSA,<sup>10</sup> including, among other things, the handling of contested disciplinary proceedings

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<sup>5</sup> Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550, 3556 (January 23, 2006).

<sup>6</sup> Under Nasdaq Rule 9120(t), Nasdaq Regulation includes the Nasdaq Enforcement Department.

<sup>7</sup> Securities Exchange Act Release No. 85505 (April 3, 2019), 84 FR 14170, 14171 (April 9, 2016).

<sup>8</sup> As appropriate, Nasdaq Regulation coordinates with other SROs to the extent it is investigating activity occurring on non-Nasdaq options markets to ensure no regulatory duplication occurs.

<sup>9</sup> With respect to the operational responsibilities described, Nasdaq Regulation already performed these functions for the Nasdaq PHLX LLC (“Phlx”), Nasdaq ISE, LLC (“ISE”), Nasdaq GEMX, LLC (“GEMX”), and Nasdaq MRX, LLC (“MRX”) because there is no comparable rule to Rule General 1, Section 7 on those markets. Nasdaq BX, Inc. (“BX”), which does have a comparable rule to Rule General 1, Section 7, received Commission approval to perform these functions in June 2019. See Securities Exchange Act Release No. 86051 (June 6, 2019), 84 FR 27387 (June 22, 2019).

<sup>10</sup> In addition to work performed pursuant to a RSA, FINRA also performs work for matters covered by agreements to allocate regulatory responsibility under Rule 17d-2 of the Act.

arising out of Nasdaq Regulation-led investigation and enforcement activities.<sup>11</sup> Nasdaq now requests Commission approval to reallocate operational responsibility from FINRA to Nasdaq Regulation for certain enforcement activity, namely the handling of contested disciplinary proceedings through the use a third party, not just FINRA.<sup>12</sup>

In its prior request for Commission approval to reallocate operational responsibility from FINRA to Nasdaq Regulation for certain investigation and enforcement functions, the Exchange noted that its expertise in its own market structure coupled with its expertise in surveillance activities will enable it to conduct investigation and enforcement responsibilities for the Exchange effectively, efficiently and with immediacy.<sup>13</sup> The Exchange believes that assuming responsibility for litigating contested disciplinary proceedings through the use of more than one third party will similarly ensure that matters are handled effectively, efficiently and with immediacy. As it does with FINRA, the Exchange would directly oversee the work performed by the third party. This will ensure that the Exchange continues to bring to bear its overall market and surveillance expertise throughout the disciplinary proceedings. Moreover, the Exchange will only use third parties that have the requisite legal experience, ensuring that only

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<sup>11</sup> For example, pursuant to Rule 9216, if at the conclusion of a Nasdaq Regulation-led investigation, Nasdaq Regulation has reason to believe that a violation occurred but the Respondent disputes the violation and therefore does not execute an Acceptance, Waiver, and Consent (“AWC”) letter, or if the Respondent executes the AWC letter but the Nasdaq Review Council, Review Subcommittee or FINRA’s Office of Disciplinary Affairs does not accept the executed letter, the Exchange may decide to pursue formal disciplinary proceedings. In such a case, the Exchange would refer the matter to FINRA to handle the formal disciplinary proceedings on its behalf. FINRA’s Office of Hearing Officers continues to be responsible for the administration of the hearing process.

<sup>12</sup> A third party may include a law firm or another self-regulatory organization. The Exchange will continue to use FINRA’s Office of Hearing Officers to administer the hearing process.

<sup>13</sup> Securities Exchange Act Release No. 85153 (February 15, 2019), 84 FR 5748, 5752 (February 22, 2019).

those third parties with the appropriate qualifications handle contested matters on the Exchange's behalf. Having the option to use a third party other than FINRA will also ensure that contested cases are handled promptly when, for example, FINRA's litigation resources are strained or when it is otherwise unable to handle a particular matter.<sup>14</sup> The Exchange notes that this proposal would not change or alter in any way the disciplinary processes around how contested matters are handled.

Nasdaq Rule General 1, Section 7 requires that Nasdaq obtain Commission approval if regulatory functions subject to RSAs in effect at the time that Nasdaq began to operate as a national securities exchange are no longer performed by FINRA or an affiliate thereof, or by another independent self-regulatory organization. Nasdaq believes that assuming operational responsibility for contested disciplinary proceedings by using more than one third party to litigate such matters will further its regulatory program and benefit investors and the markets. Commission approval of the proposal would allow Nasdaq to deliver increased efficiencies in the regulation of its market and to act promptly and provide more effective regulation.<sup>15</sup>

Finally, Nasdaq notes that its proposal is consistent with work performed by other national securities exchanges. For example, in 2015, the SEC approved the New York Stock Exchange's ("NYSE") application whereby NYSE amended certain of its disciplinary rules to facilitate the reintegration of certain market surveillance, investigation and enforcement

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<sup>14</sup> The Exchange intends to continue to use FINRA to handle contested disciplinary proceedings. The Exchange is requesting permission to have the option to use a third party other than FINRA when it believes that doing so is consistent with ensuring prompt resolution of regulatory matters.

<sup>15</sup> BX, which has a comparable rule to Rule General 1, Section 7, will file a similar rule filing to request Commission approval to use a third party to handle contested disciplinary proceedings.

functions performed on behalf of NYSE by FINRA.<sup>16</sup> That reintegration also included the handling of contested disciplinary proceedings.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>17</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>18</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest. In addition, the Exchange believes that the proposal furthers the objectives of Section 6(b)(7) of the Act,<sup>19</sup> in particular, in that these changes will continue to provide for fair procedures for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the Exchange of any person with respect to access to services offered by the Exchange or a member thereof.

The Exchange believes that this proposal is in keeping with those principles because it will ensure that contested matters are handled effectively, efficiently and with immediacy. The ability to assume responsibility for this function by using more than one party to handle contested matters will ensure that contested cases are handled promptly when, for example,

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<sup>16</sup> See Securities Exchange Act Release No. 75721 (August 18, 2015), 80 FR 51334 (August 24, 2015) and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1, 3 and 5, Amending Exchange Disciplinary Rules to Facilitate the Reintegration of Certain Regulatory Functions from Financial Industry Regulatory Authority, Inc., Securities Exchange Act Release No. 76436 (November 13, 2015), 80 FR 72460 (November 19, 2015) (SR-NYSE-2015-35).

<sup>17</sup> 15 U.S.C. 78f(b).

<sup>18</sup> 15 U.S.C. 78f(b)(5).

<sup>19</sup> 15 U.S.C. 78f(b)(7).

FINRA's litigation resources are strained or when it is otherwise unable to handle a particular matter. This will enable the Exchange to take timely action when appropriate to enforce its rules, hold bad actors accountable, and protect investors and market integrity. This proposal, however, would not change or alter in any way the disciplinary processes around how contested matters are handled. Rather, it will result in more effective regulation because it will facilitate timely and more efficient action. Internalizing the litigation function through the use of a third party other than FINRA will also enhance regulation because the Exchange will continue to bring to bear its overall market and surveillance expertise throughout the disciplinary proceedings. Moreover, the Exchange, consistent with its statutory obligations, will only use third parties that have the requisite legal experience, ensuring that only those third parties with the appropriate qualifications handle contested matters on the Exchange's behalf.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is not intended to address competitive issues but rather to enable the Exchange to have the option to use a third party other than FINRA to litigate contested matters on the Exchange's behalf.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the *Federal Register* or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which

the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act.

Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2020-007 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2020-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F



Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2020-007 and should be submitted on or before **[INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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<sup>20</sup> 17 CFR 200.30-3(a)(12).

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